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The Current Economic Crisis and the Welfare State

Peter A. Hall

What is the significance of the current economic crisis for the welfare state? Will the financial crisis and economic recession of 2008-2009 inspire renewed appreciation for the value of social safety-nets or cut-backs in spending that threaten social solidarity? Only time will tell, but it is not too early to make some tentative predictions.

We should begin by recognizing that the import of the crisis is different in different types of political economies, and not only, as the French Finance Minister has said, because the welfare states of continental Europe have automatic stabilizers lacking in the countries Gösta Esping-Andersen described as liberal welfare states. Stylizing slightly, we can distinguish two very different ‘growth models’ in the economic strategies of the developed democracies over the past two decades. Especially relevant are differences in how they resolved two key problems, namely, the problem of ensuring adequate demand for their products and the problem of mobilizing political consent for the neo-liberal policies that all have pursued to one degree or another over the past two decades. The latter is a serious problem because neo-liberal policies tend to increase wage inequality, and so cannot be presented as a ‘class compromise’ because they deliver more obvious benefits to people on one side of the class divide than to those on the other.

Over the last twenty years, several liberal market economies, such as the U.S. and the U.K., have embraced models in which economic growth is led by consumer demand. But this is not easy to accomplish when median and below-median incomes are stagnating, as they have been for more than a decade in the United States. Thus, as

Raghuram Rajan has observed, the indispensable complement has been financial regulations that offered consumers cheap credit, to see them through adverse life events or fluctuations in the economy, and ready access to government-guaranteed mortgages that fed housing booms, giving many people the illusion that their wealth was increasing even if their real incomes were not. These measures also mobilized consent for neo-liberal policies that on any standard assessment would not seem to benefit ordinary voters. Fueled by the cheaper credit that entry into European monetary union and German export surpluses provided, several southern European countries also pursued variants of this growth model over the past decade.

By contrast, in these years, the continental economies of northern Europe developed growth models in which demand was led by exports that were made competitive through processes of coordinated wage bargaining and incremental innovation. The varieties-of-capitalism literature explains why these political economies were well-suited to such strategies. In continental Europe, political consent for neo-liberal policies has been secured in two ways over the past twenty years. On the one hand, more generous social programs were used to offset the effects of rising wage inequality on disposable income. On the other hand, measures that began with the Single European Act of 1986 turned the European Union into an agent for market liberalization behind which national governments could hide.

At first glance, we might think that the fiscal problems generated by the recent economic recession pose the biggest problems for the largest welfare states, such as those in northern Europe. With these models as a backdrop, however, we can see that, paradoxically, just the reverse is the case. The real crisis of the welfare state is likely to

occur in the liberal market economies, for two reasons. First, these countries incurred especially high deficits in the wake of the crisis in order to revive growth based on longstanding models led by consumer demand, and thus serious cutbacks may be required there to restore fiscal balance. Second, the dramatic reductions in lending that followed the financial crisis have especially severe consequences in economies where the well-being of ordinary people has depended so heavily on housing booms and easy access to credit – essentially hidden features of the Anglo-American welfare states. Thus, it is in the already-residual welfare states of the US and Britain that social protection and the well-being of the poor are likely to suffer the most in the coming years.

Much the same can be said of southern Europe, although sovereign debt crises are forcing even more immediate and draconian spending cuts there, while the effects of the crisis on the welfare states of northern Europe are likely to be less substantial. Even there, efforts to restore fiscal balance will eat into social benefits, but export-led growth should ease the pain, and, in most of these countries, ordinary people are less dependent on consumer lending to sustain their well-being.

What might the long-term effects of the crisis be on political support for the welfare state? At first glance, we might expect that support to rise, since the negative socioeconomic impact of the crisis would have been much greater were it not for the social safety-nets that welfare states now provide, and the failure of many market-oriented policies that the crisis revealed might be expected to revive interest in more interventionist policies. In some countries where the crisis is especially severe, that might happen.

On the whole, however, there are several reasons to expect a more muted response, marked by a reluctance to increase the role of the state in the economy. First, despite the examples of Franklin D. Roosevelt and the Swedish social democrats often cited today, there is no Say's law in politics: economic crisis does not automatically call forth political mobilization on the left. History teaches us that economic downturns are just as likely to inspire a nativist response, characterized by increasing hostility to immigrants and rising support for the radical right. Second, ordinary people do not simply blame markets for economic crises: they also blame governments. Still influenced by a Keynesian era that is otherwise past, they hold governments responsible for rising unemployment. Virtually every government in power during the deep recession of the 1970s was turned out of office at the next election. Across Europe and America, distrust in government has been rising for more than a decade. People want relief from the crisis, but they do not necessarily think that more interventionist governments can provide it.

These factors go some distance toward explaining both the popularity of the Tea Party movement in the United States and the fact that the British electorate turned out a government committed to social justice in favor of one committed to fiscal austerity. Of course, the political pendulum is going to swing back and forth, but it is not necessarily going to turn toward the political left. Much will depend on who is currently in power and thus blamed for a bitter economic crisis.

Therefore, in the long run as well as the short term, we can expect the welfare states of northern Europe to endure, despite some marginal adjustments, while those at

the margins of the labor market in Britain, the U.S., Ireland and southern Europe have good reason to worry whether their already-limited levels of social protection will survive the fall-out from this economic crisis.

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